



DRAFT DECISION
TasNetworks distribution
determination
2017–18 to 2018–19

Attachment 14 – Control
mechanisms

September 2016

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Note

This attachment forms part of the AER's draft decision on TasNetworks' distribution determination for 2017–19. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Demand management incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

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Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for Electricity Distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure

Shortened form	Extended form
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

14 Control mechanisms

A control mechanism imposes limits over the prices of direct control services and/or the revenues that a distribution network service provider can recover from customers. For standard control services, the National Electricity Rules requires the control mechanism be of the prospective CPI–X form (or some incentive-based variant).¹

This attachment sets out the revenue cap as the control mechanism for TasNetworks' standard control services for the 2017–19 regulatory control period. It discusses:

- the application of the revenue cap
- compliance with the price controls²
- the mechanism through which TasNetworks will recover distribution use of system (DUoS) charges—including adjustments for revenue under or over recovery—in the 2017–19 regulatory control period³
- how TasNetworks must report to us on its recovery of designated pricing proposal charges and jurisdictional scheme amounts⁴
- the procedures TasNetworks must apply for assigning or reassigning retail customers to tariff classes.⁵

The control mechanisms applying to TasNetworks' alternative control services are set out separately in attachment 16.

14.1 Draft decision

Our draft decision for TasNetworks is as follows:

- The control mechanism for standard control services is a revenue cap.⁶
- Section 14.4.4 contains the revenue cap formulas.
 - The revenue cap for any given regulatory year is the total annual revenue, or TAR, calculated using the formula in figure 14.1.
 - The side constraints applying to price movements for each of TasNetworks' tariff classes must be consistent with the formula in figure 14.2.

¹ NER, cl. 6.2.6(a).

² NER, cl. 6.12.1(13).

³ NER, cl. 6.12.1(11).

⁴ NER, cll. 6.12.1(19) and 6.12.1(20).

⁵ NER, cl. 6.12.1(17).

⁶ AER, *Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017*, July 2015, p. 14; TasNetworks, *AER information request: TasNetworks response to questions raised by the AER*, 7 March 2016, p. 4 (TasNetworks, *Response to questions raised by the AER*, 7 March 2016).

- TasNetworks must demonstrate compliance with the revenue cap—in accordance with figure 14.1—by including adjustments for DUoS revenue under or over recovery in accordance with appendix A of this attachment.
- TasNetworks must submit as part of its annual pricing proposal, a record of the amount of revenue recovered from designated pricing proposal charges and associated payments in accordance with appendix B of this attachment.
- TasNetworks must submit as part of its annual pricing proposal, a record of any jurisdictional scheme amounts it recovers and associated payments in accordance with appendix C of this attachment.
- Appendix D of this attachment specifies the procedures TasNetworks must apply in assigning retail customers to tariff classes or reassigning retail customers from one tariff class to another.

14.2 TasNetworks' proposal

TasNetworks' proposal did not comment on the control mechanism for standard control services. We raised this with TasNetworks which subsequently provided a response clarifying its proposal on the control mechanism.⁷

TasNetworks' response stated that it accepted the revenue cap control mechanism as set out in the AER's final framework and approach (final F&A).⁸ It also proposed that the B factor parameter of the control mechanism include:

- adjustments for the present value of the DUoS unders and overs account
- annual 'true-up' adjustments for the Electrical Safety Inspection Service charge and the National Energy Market charge
- pass through of additional costs imposed on TasNetworks by jurisdictional legislation, and
- pass through of additional costs for participation in the National Electricity Market.⁹

14.3 Assessment approach

Our assessment of the control mechanism was set out in our final F&A. The final F&A set the control mechanism for standard control services as a revenue cap which is then binding on our determination.¹⁰ The basis of the revenue cap must be of the prospective CPI-X form (or some incentive based variant).¹¹

⁷ TasNetworks, *Response to questions raised by the AER*, 7 March 2016.

⁸ TasNetworks, *Response to questions raised by the AER*, 7 March 2016, p. 4.

⁹ TasNetworks, *Response to questions raised by the AER*, 7 March 2016, p. 4.

¹⁰ AER, *Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017*, July 2015, p. 14; NER, cl. 6.12.3(c).

¹¹ NER, cl. 6.2.6(a).

Our final F&A deliberately set out a generic formula to give effect to the control mechanism for standard control services.¹² The generic formula requires the control mechanism parameters be specified with more precision in order to be implemented. This draft decision clarifies our position regarding the control mechanism formula and its respective parameters.

14.4 Reasons for draft decision

The following discusses the reasons for our draft decision for each parameter of the revenue cap control mechanism, including the reporting on designated pricing proposal charges and jurisdictional scheme amounts.

14.4.1 Application of the revenue cap

Total annual revenue

The revenue cap for any given regulatory year is the total annual revenue (TAR) for standard control services. Figure 14.1 contains the revenue cap formula.

Intra-period adjustment to the weighted average cost of capital

Changes to the TAR resulting from the trailing average cost of debt update will be implemented through annual revisions to the X factors. Further discussion on this adjustment can be found in attachment 3—rate of return—which discusses the WACC annual adjustment and attachment 1—annual revenue requirement—which details issues relating to X factors.

Incentive scheme adjustments (I factor)

The I factor parameter is for annual TAR adjustments relating to a distributor's performance against the incentive schemes.¹³ TasNetworks proposed to include in the I factor the final carryover amount from the demand management incentive scheme (DMIS) applied in the 2012–17 regulatory control period.¹⁴ We accept this approach as it is consistent with the applicable DMIS and our final F&A.¹⁵

The final carryover amount is not known at the time of making the 2017–19 determination and must therefore be applied via the control mechanism. Specifically, the DMIS adjustment includes:

¹² AER, *Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017*, July 2015, pp. 53–54.

¹³ The I factor excludes adjustments relating to performance against the service target performance incentive scheme which is applied under a specified S factor. The S factor is discussed below.

¹⁴ TasNetworks, *AER information request: TasNetworks response to questions raised by the AER – IR007*, 4 April 2016, p. 8.

¹⁵ AER, *Demand management incentive scheme, Aurora Energy, Regulatory control period commencing 1 July 2012*, 15 October 2010; AER, *Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017*, July 2015, pp. 72–75.

- any amount of allowance unspent or not approved by the AER over the period
- the time value of money accrued or lost as a result of the expenditure profile selected by the distributor.¹⁶

This adjustment will be calculated by TasNetworks and added or deducted from the TAR in its 2018–19 pricing proposal. We will consider these amounts as part of our assessment of that pricing proposal.

Annual adjustments (B factor)

The B factor parameter is for annual TAR adjustments required within the 2017–19 regulatory control period. Consistent with our final F&A, the B factor will include 'true-up' adjustments for DUoS revenue under or over recovery, the Electrical Safety Inspection Service charge and the National Energy Market charge.¹⁷ In addition to these adjustments, TasNetworks also proposed to include general adjustments for:

- amounts that may arise from obligations under jurisdictional legislation, and
- amounts that it may incur for participating in the National Electricity Market beyond those already accounted for through the National Energy Market charges.¹⁸

The following discusses our draft decision on these adjustments.

True-up of under or over recovered DUoS revenue

The B factor will include a true-up for the net present value of under or over recovered revenue. These true-ups will be calculated through the DUoS unders and overs account in accordance with appendix A.

Under a revenue cap, TasNetworks' revenues in year t will be adjusted annually to clear (or true-up) any under or over recovery of actual revenue collected through DUoS charges in year $t-2$ and any estimated under or over recovery of revenues in year $t-1$. With these arrangements, there is a lag between the year the under or over recovery of revenue occurs and the year in which the true-up adjustment is made. To account for this lag, the true-up method will include net present value adjustments.

Our draft decision approach to the DUoS unders and overs account differs to the approach applied to TasNetworks over the 2012–17 regulatory control period. The difference relates to the approach to calculating the net present value of the under or over recovery.

¹⁶ AER, *Demand management incentive scheme, Aurora Energy, Regulatory control period commencing 1 July 2012*, 15 October 2010, p. 7.

¹⁷ AER, *Framework and approach for TasNetworks Distribution for the Regulatory control period commencing 1 July 2017*, July 2015, p. 54.

¹⁸ TasNetworks, *Response to questions raised by the AER*, 7 March 2016, p. 4.

We reviewed the approaches to calculating the net present value in the DUoS unders and overs accounts across jurisdictions. We consider our draft decision approach—which aligns with most other jurisdictions—better reflects the timing of cash flows than the current approach applied to TasNetworks.

Our draft decision approach applies a full year of interest to opening balances in each year of the unders and overs account to recognise that these cash flows were incurred in the previous year. Then the approach applies a half year of interest to under and over recovery incurred during a year to reflect that these cash flows are not incurred all on one day but rather incurred across the year. We consider this approach is more reliable than the current approach which applies a full year of interest to both the opening and in-period balances for year $t-2$ and year $t-1$ but no adjustments in year t .

We also note that apart from Queensland, our draft decision approach is consistent with the approach applied in all other jurisdictions where a revenue cap is applied.¹⁹ We consider regulatory consistency across jurisdictions is desirable.²⁰

True-up of under or over recovered Electrical Safety Inspection Service and National Energy Market charge revenue

The B factor will also include annual TAR adjustments to true-up the difference between the estimated costs included in TasNetworks forecast operating expenditure and the actual costs it incurs relating to:

- Electrical Safety Inspection Service charges
- National Energy Market charges.

We note TasNetworks is required to undertake electrical inspection services on behalf of Workplace Standards Tasmania in accordance with the *Electricity Industry Safety and Administration Act 1997*. Under the *Electricity Supply Industry Act 1995* (ESI Act), the Minister imposes an electrical inspection service charge on TasNetworks to perform these services. TasNetworks is then allowed to recover these costs from customers through its tariffs.

Also under the ESI Act, TasNetworks is required to contribute to Tasmania's costs of funding the Australian Energy Market Commission (the National Energy Market charge). Under the ESI Act, the Minister determines the amount TasNetworks must contribute. TasNetworks also recovers these costs from customers through its tariffs.

As these are uncontrollable costs, an estimate of the two charges are included in TasNetworks' forecast operating expenditure and annual adjustments are made to the

¹⁹ For example, see: AER, *Final decision: Ausgrid distribution determination 2015–16 to 2018–19: Attachment 14–Control mechanisms*, April 2015, Appendix A; AER, *Final decision: SA Power Networks determination 2015–16 to 2019–20: Attachment 14–Control mechanisms*, October 2015, Appendix A; AER, *Final decision: AusNet Services distribution determination 2016 to 2020: Attachment 14–Control mechanisms*, May 2016, Appendix A.

²⁰ NER, cl. 6.2.5(c)(4).

TAR to true-up the difference between the estimate and actual costs. This approach is consistent with current regulatory practice for TasNetworks.

These true-ups will be calculated in accordance with the control mechanism formula in figure 14.1. These true-up methods are the same as the methods applied in the 2012–17 regulatory control period.

General regulatory adjustments

We do not accept TasNetworks proposed adjustments for:

- amounts that may arise from obligations under jurisdictional legislation, and
- amounts that it may incur for participating in the National Electricity Market beyond those already accounted for through the National Energy Market charges.²¹

We do not accept the proposed adjustments because—as noted by TasNetworks—there is no certainty as to what would be included in these adjustments and whether any adjustment would actually be required.²² We consider given the uncertainty regarding these adjustments, the general 'catch-all' definitions of the kind proposed is not consistent with incentive regulation. A distributor should manage uncertain events as part of its normal business practice, unless they come within the pass through event regime which is used for more exceptional or material cases. Incentive regulation is not intended to account for all events that may occur during a regulatory control period.

We also note that a regulatory change event is included in all distribution determinations as a pass through event which is discussed in attachment 15—pass through events.²³ The C factor in our draft decision control mechanism (set out below) makes provision for TAR adjustments related to pass through events.

Cost pass through adjustments (C factor)

The C factor is for annual TAR adjustments relating to an AER approved cost pass through amounts. The types of costs that can be included as a cost pass through are set out in attachment 15—pass through events.

S factor adjustments

The S factor parameter is for annual TAR adjustments relating to a distributor's performance against the service target performance incentive scheme. The S factor gives effect to any rewards or penalties related to this scheme—including across

²¹ TasNetworks, *Response to questions raised by the AER*, 7 March 2016, p. 4.

²² TasNetworks, *AER information request: TasNetworks response to questions raised by the AER—IR007 Revenue control mechanism*, 4 May 2016, p. 7.

²³ NER, cl. 6.6.1(a1)(1).

regulatory control periods. The scheme requires the S factor to be applied as a percentage adjustment to annual revenue.²⁴

The service target performance incentive scheme applying to TasNetworks in the 2017–19 regulatory control period is discussed in attachment 11.

Calculation of the consumer price index escalation

We will apply the annual movement between the Australian Bureau of Statistics' (ABS) published December quarter data for calculating the consumer price index (CPI) escalation.²⁵ Our draft decision application is a change to CPI escalation applied during the 2012–17 regulatory control period, which was based on movements in the March quarter data.

We note the use of the December quarter data will mean that TasNetworks will apply an actual CPI escalation (rather than an estimated or 'placeholder' CPI escalation) when it submits its pricing proposals.²⁶ The use of an actual CPI escalation will allow the process for setting prices to be more transparent which is consistent with the intent of the Australian Energy Market Commission pricing rule changes.²⁷

The application of this calculation is set out in figure 14.1.

14.4.2 Reporting on designated pricing proposal charges

We must decide how TasNetworks will report on the recovery of designated pricing proposal charges for each year of the 2017–19 regulatory control period and how to account for any under or over recovery of revenue associated with those charges.²⁸

We apply an under and over recovery mechanism to facilitate this reporting and account for the true-up of under and over recovery of revenue. This approach is the same as the DUoS revenue under and over recovery mechanism and is consistent with the requirements of the NER.²⁹ The operation of this method is detailed in appendix B.

²⁴ AER, *Electricity distribution network service providers: Service target performance incentive scheme: Appendix C*, 1 November 2009, p. 32.

²⁵ As the same timing of CPI escalation will be used for the RAB roll forward at the next regulatory reset for TasNetworks in 2019, this change will allow us to update the actual CPI for RAB roll forward purposes well before the publication date of the AER's decision at the next reset. We note that there will be an overlapping issue of the March quarter CPI when the transition to the December quarter CPI occurs (this will occur in the year 2017–18 for TasNetworks). This is because the CPI for the March quarter 2017 will be reflected in both 2016–17 and 2017–18. However, we consider this is only a transitional issue and will not have a material impact on the TasNetworks' prices or revenue.

²⁶ Apart from the initial year of the regulatory control period.

²⁷ AEMC, *Rule determination: National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014*, 27 November 2014, p. i.

²⁸ NER, cl. 6.12.1 (19).

²⁹ NER, cll. 6.12.1(19), 6.18.7.

14.4.3 Reporting on jurisdictional scheme amounts

We must decide how TasNetworks will report on the recovery of jurisdictional scheme amounts for each year of the 2017–19 regulatory control period and how to account for any under or over recovery of revenue associated with those charges.³⁰

TasNetworks does not envisage that it will be subject to a jurisdictional scheme over the 2017–19 regulatory control period.³¹ However, our draft decision includes an under and over recovery mechanism to facilitate any reporting of a jurisdictional scheme should one be imposed upon TasNetworks. This inclusion will negate a requirement to remake the distribution determination in the event a jurisdictional scheme applies.

Our draft decision jurisdictional scheme amounts under and over recovery mechanism approach is the same as the DUoS revenue under and over recovery mechanism and is consistent with the requirements of the NER.³² It is also consistent with the approach applied to electricity distributors in other jurisdictions.³³ The operation of this method is detailed in appendix C.

14.4.4 Control mechanism formulas

TasNetworks' revenues must be consistent with the total annual revenue and side constraint formula set out in figure 14.1 and figure 14.2.

Figure 14.1 Revenue cap formula³⁴

$$(1) \quad TAR_t \geq \sum_{i=1}^n \sum_{j=1}^m p_t^{ij} q_t^{ij} \quad i = 1, \dots, n \text{ and } j = 1, \dots, m \text{ and } t = 1, 2$$

$$(2) \quad TAR_t = AAR_t + I_t + B_t + C_t \quad t = 1, 2$$

$$(3) \quad AAR_t = AR_t(1 + S_t) \quad t = 1$$

$$(4) \quad AAR_t = AAR_{t-1}(1 + \Delta CPI_t)(1 - X_t)(1 + S_t) \quad t = 2$$

where:

TAR_t is the total allowable revenue in year t.

³⁰ NER, cl. 6.12.1 (20).

³¹ TasNetworks, *AER information request: TasNetworks response to questions raised by the AER—IR007 Revenue control mechanism*, 4 May 2016, p. 8.

³² NER, cl. 6.18.7A.

³³ For example, see: AER, *Final decision: Ausgrid distribution determination 2015–16 to 2018–19: Attachment 14—Control mechanisms*, April 2015, Appendix C; AER, *Final decision: SA Power Networks determination 2015–16 to 2019–20: Attachment 14—Control mechanisms*, October 2015, Appendix C; AER, *Final decision: AusNet Services distribution determination 2016 to 2020: Attachment 14—Control mechanisms*, May 2016, Appendix C.

³⁴ All parameters are in nominal terms unless otherwise specified.

p_t^{ij} is the price of component 'j' of tariff 'i' in year t.

q_t^{ij} is the forecast quantity of component 'j' of tariff 'i' in year t.

AR_t is the annual smoothed revenue requirement in the Post Tax Revenue Model (PTRM) for year t.³⁵

AAR_t is the adjusted annual smoothed revenue requirement for year t.

I_t is the final carryover amount from the application of the DMIS from the 2012–17 regulatory control period. This amount will be calculated using the method set out in the DMIS and will be deducted from/added to allowed revenue in the 2018–19 pricing proposal.

B_t is the sum of the following annual adjustment factors for year t:

- any under or over recovery of actual revenue collected through DUoS charges calculated using the method in appendix A
- any under or over recovery of the Electrical Safety Inspection Service charge, calculated using the following method:

$$ESISC_t = (ESISCa_{t-1} - ESISCe_{t-1}) \times WACC_t$$

where:

$ESISCa_{t-1}$ is the actual Electrical Safety Inspection Service charge for year t–1

$ESISCe_{t-1}$ is the estimated Electrical Safety Inspection Service charge for year t–1 as set out in table 14.1

$WACC_t$ is the approved nominal weighted average cost of capital (WACC) for the relevant regulatory year using the following method:

$$Nominal\ vanilla\ WACC_t = ((1 + real\ vanilla\ WACC_t) \times (1 + \Delta CPI_t)) - 1$$

where the *real vanilla WACC_t* is as set out in our final decision PTRM and updated annually.

³⁵ Our final F&A stated that if necessary an adjustment for inflation may be required to the annual smoothed revenue requirement for year t. However, as the annual smoothed revenue requirement for year t as stated in our preliminary decision PTRM is in nominal dollars there is no need to adjust it for inflation. This approach is consistent with past regulatory practice.

Table 14.1 AER draft decision on estimated Electrical Safety Inspection Service charge (\$million, 2016–17)

	2016-17	2017-18	2018-19
ESISCe	3.704 ^a	2.034	2.034

Source: AER analysis.

(a.) Is the amount of the estimated Electrical Safety Inspection Service charge for 2016–17 provided for in the AER's final decision on TasNetworks' operating expenditure for the 2012–17 regulatory control period adjusted to real 2016–17 terms.

- any under or over recovery of the National Energy Market charge, calculated used the following method:

$$NEMC_t = (NEMCa_{t-1} - NEMCe_{t-1}) \times WACC_t$$

where:

$NEMCa_{t-1}$ is the actual National Energy Market charge for year t–1

$NEMCe_{t-1}$ is the estimated National Energy Market charge for year t–1 as set out in table 14.2

$WACC_t$ is the approved nominal weighted average cost of capital (WACC) for the relevant regulatory year as calculated above.

Table 14.2 AER draft decision on estimated National Energy Market charge (\$million, 2016–17)

	2016-17	2017-18	2018-19
NEMCe	0.428 ^a	0.415	0.415

Source: AER analysis.

(a.) Is the amount of the estimated National Energy Market charge for 2016–17 provided for in the AER's final decision on TasNetworks' operating expenditure for the 2012–17 regulatory control period adjusted to real 2016–17 terms.

C_t is the sum of approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities³⁶ from the December quarter in year t–2 to the December quarter in year t–1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t–2

minus one.

For example, for the 2017–18 regulatory year, t–2 is December quarter 2015 and t–1 is December quarter 2016 and for the 2018–19 regulatory year, t–2 is December quarter 2016 and t–1 is December quarter 2017 and so on.

X_t is the X factor for each year of the 2017–19 regulatory control period as determined in the PTRM, and annually revised for the return on debt update in accordance with the formula specified in attachment 3—rate of return—calculated for the relevant year.

S_t is the s-factor for regulatory year t.³⁷ It will also incorporate any adjustments required due to the application of the STPIS in the 2012–17 regulatory control period consistent with the AER's STPIS.³⁸

Side constraints

Figure 14.2 sets out the side constraints formula. For each regulatory year after the first year of a regulatory control period, side constraints apply to the weighted average revenue raised from each tariff class. In accordance with the NER, the permissible percentage increase is the greater of CPI–X plus 2 per cent or CPI plus 2 per cent.³⁹ Recovery of certain revenues, such as those to accommodate pass throughs, is disregarded in deciding whether the permissible percentage has been exceeded.⁴⁰

³⁶ If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

³⁷ The meaning for year “t” under the price control formula is different to that in Appendix C of STPIS. Year “t+1” in Appendix C of STPIS is equivalent to year “t” in the price control formula of this decision.

³⁸ AER, *Electricity distribution network service providers - service target performance incentive scheme*, 1 November 2009.

³⁹ NER, cl. 6.18.6(c).

⁴⁰ NER, cl. 6.18.6(d).

Figure 14.2 Side constraints formula⁴¹

$$\frac{\left(\sum_{i=1}^n \sum_{j=1}^m d_t^{ij} q_t^{ij}\right)}{\left(\sum_{i=1}^n \sum_{j=1}^m d_{t-1}^{ij} q_t^{ij}\right)} \leq (1 + \Delta CPI_t) \times (1 - X_t) \times (1 + 2\%) \times (1 + S_t) + I_t' + B_t' + C_t'$$

where each tariff class has "n" tariffs, with each up to "m" components, and where:

d_t^{ij} is the proposed price for component 'j' of tariff 'i' for year t.

d_{t-1}^{ij} is the price charged for component 'j' of tariff 'i' in year t-1.

q_t^{ij} is the forecast quantity of component 'j' of tariff 'i' in year t.

ΔCPI_t is the annual percentage change in the ABS CPI All Groups, Weighted Average of Eight Capital Cities⁴² from the December quarter in year t-2 to the December quarter in year t-1, calculated using the following method:

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-1

divided by

The ABS CPI All Groups, Weighted Average of Eight Capital Cities for the December quarter in regulatory year t-2

minus one.

For example, for the 2017-18 regulatory year, t-2 is December quarter 2015 and t-1 is December quarter 2016 and for the 2018-19 regulatory year, t-2 is December quarter 2016 and t-1 is December quarter 2017 and so on.

X_t is the X factor for each year of the 2017-19 regulatory control period as determined in the PTRM, and annually revised for the return on debt update in accordance with the formula specified in attachment 3—rate of return—calculated for the relevant year. If $X > 0$, then X will be set equal to zero for the purposes of the side constraint formula.

S_t is the s-factor for regulatory year t.⁴³ It will also incorporate any adjustments required due to the application of the STPIS in the 2012-17 regulatory control period consistent with the AER's STPIS.⁴⁴

⁴¹ All parameters are in nominal terms unless otherwise specified.

⁴² If the ABS does not or ceases to publish the index, then CPI will mean an index which the AER considers is the best available alternative index.

I_t' is the percentage change from the final carryover amount from the application of the DMIS from the 2012–17 regulatory control period. This amount will be calculated using the method set out in the DMIS and will be deducted from/added to allowed revenue in the 2018–19 pricing proposal.

B_t' is the percentage change from the sum of the following annual adjustment factors for year t:

- any under or over recovery of actual revenue collected through DUoS charges calculated using the method in appendix A
- any under or over recovery of the Electrical Safety Inspection Service charge, calculated using the method in figure 14.1
- any under or over recovery of the National Energy Market charge, calculated using the method in figure 14.1.

C_t' is the annual percentage change from the sum of approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER.

With the exception of the CPI, X factor and S factor, the percentage for each of the other factors above can be calculated by dividing the incremental revenues (as used in the total annual revenue formula) for each factor by the expected revenues for regulatory year t–1 (based on the prices in year t–1 multiplied by the forecast quantities for year t).

⁴³ The meaning for year “t” under the price control formula is different to that in Appendix C of STPIS. Year “t+1” in Appendix C of STPIS is equivalent to year “t” in the price control formula of this decision.

⁴⁴ AER, *Electricity distribution network service providers - service target performance incentive scheme*, 1 November 2009.

A DUoS unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2017–19 regulatory control period, TasNetworks must maintain a DUoS unders and overs account in its annual pricing proposal.⁴⁵

TasNetworks must provide the amounts for the following entries in their DUoS unders and overs account for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):

1. An opening balance for year t–2, year t–1 and year t;
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the respective nominal weighted average cost of capital (WACC) for each intervening year between regulatory year t–2 and year t.⁴⁶ The WACC applied for each year will be that approved by the AER for the relevant year;
3. The amount of revenue recovered from DUoS charges in respect of that year, less the total annual revenue for the year in question;
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the approved nominal WACC;
5. The total sum of items 1–4 to derive the closing balance for each year.

TasNetworks must provide details of calculations in the format set out in table 14.3. Amounts provided for the most recently completed regulatory year (t–2) must be audited. Amounts provided for the current regulatory year (t–1) will be regarded as an estimate. Amounts for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of DUoS charges, TasNetworks is expected to achieve a closing balance as close to zero as practicable in its DUoS unders and overs account in each forecast year in its annual pricing proposals during the 2017–19 regulatory control period.

⁴⁵ NER, cl. 6.18.2(b)(7).

⁴⁶ The WACC for each year will be that approved by the AER for the respective year and as calculated as set out in Figure 14.1.

Table 14.3 Example calculation of DUoS unders and overs account (\$'000, nominal)

	Year t-2 (actual)	Year t-1 (estimate)	Year t (forecast)
(A) Revenue from DUoS charges	46 779	40 269	39 510
(B) Less TAR for regulatory year =	43 039	41 427	44 429
+ Adjusted annual smoothed revenues (AAR _t)	40 189	41 393	44 393
+ f-factor scheme amount (I _t)	-12	10	14
+ DMIS carryover amount (T _t)	1013	0	0
+ Annual adjustments (B _t) ^a =	1849	24	22
+ License fee recovery	25	24	22
+ Approved pass through amounts	1824	0	0
(A minus B) Under/over recovery of revenue for regulatory year	3740	-1158	-4919^b
DUoS unders and overs account			
Nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	1737	5656 ^c	4778
Interest on opening balance	87	311	287
Under/over recovery of revenue for regulatory year	3740	-1158	-4919 ^b
Interest on under/over recovery for regulatory year	92	-31	-145
Closing balance	5656	4778	0^d

Notes: (a) Bt parameter calculations in the DUoS unders and overs account exclude approved DUoS revenue under/over recovery for regulatory year.
(b) Approved DUoS revenue under/over recovery for regulatory year t.
(c) Opening balance is the previous year's closing balance.
(d) TasNetworks is expected to achieve a closing balance as close to zero as practicable in its DUoS unders and overs account in each forecast year in its annual pricing proposals in the 2017–19 regulatory control period.

B Designated pricing proposal charges⁴⁷ unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2017–19 regulatory control period, TasNetworks must maintain a designated pricing proposal charges unders and overs account in its annual pricing proposal.⁴⁸

TasNetworks must provide the amounts for the following entries in its designated pricing proposal charges unders and overs account for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):

1. An opening balance for year t–2, year t–1 and year t;
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the respective nominal weighted average cost of capital (WACC) for each intervening year between regulatory year t–2 and year t.⁴⁹ The WACC applied for each year will be that approved by the AER for the relevant year;
3. The amount of revenue recovered from designated pricing proposal charges in respect of that year, less the total annual revenue for the year in question;
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the approved nominal WACC;
5. The total sum of items 1–4 to derive the closing balance for each year.

TasNetworks must provide details of calculations in the format set out in table 14.4. Amounts provided for the most recently completed regulatory year (t–2) must be audited. Amounts provided for the current regulatory year (t–1) will be regarded as an estimate. Amounts for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of designated pricing proposal charges, TasNetworks is expected to achieve a closing balance as close to zero as practicable in its designated pricing proposal charges unders and overs account in each forecast year in its annual pricing proposals during the 2017–19 regulatory control period.

⁴⁷ Designated pricing proposal charges, are charges related to: designated pricing proposal services (prescribed exit fees, prescribed common transmission services and prescribed transmission use of system services); avoided customer transmission use of system charges; charges provided by another distributor (but only to the extent they comprise of designated pricing proposal services or standard control services); and charges or payments related specified in NER clause 11.39.

⁴⁸ NER, cll. 6.18.2(b)(6), 6.12.1(19), 6.18.7.

⁴⁹ The WACC for each year will be that approved by the AER for the respective year and as calculated as set out in Figure 14.1.

Table 14.4 Example calculation of designated pricing proposal charges unders and overs account (\$'000, nominal)

	Year t-2 (actual)	Year t-1 (estimate)	Year t (forecast)
(A) Revenue from designated pricing proposal charges (DPPC)	40 077	34 944	36 609
(B) Less DPPC related payments for regulatory year =	34 365	38 734	39 200
+ DPPC charges to be paid to TNSP	33 672	37 933	38 000
+ Avoided TUoS/DPPC payments	572	734	800
+ Inter-distributor payments	121	67	400
(A minus B) Under/over recovery of revenue for regulatory year	5712	-3790	-2540^a
DPPC unders and overs account			
Nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	167	6028 ^b	2467
Interest on opening balance	8	332	148
Under/over recovery of revenue for regulatory year	5712	-3790	-2540 ^a
Interest on under/over recovery for regulatory year	141	-103	-75
Closing balance	6028	2467	0^c

Notes: (a) Approved DPPC revenue under/over recovery for regulatory year t.
(b) Opening balance is the previous year's closing balance.
(c) TasNetworks is expected to achieve a closing balance as close to zero as practicable in its DPPC unders and overs account in each forecast year in its annual pricing proposals in the 2017–19 regulatory control period.

C Jurisdictional scheme amounts⁵⁰ unders and overs account

To demonstrate compliance with the distribution determination applicable to it during the 2017–19 regulatory control period, TasNetworks must maintain a jurisdictional scheme amounts unders and overs account in its annual pricing proposal.⁵¹

TasNetworks must provide the amounts for the following entries in its jurisdictional scheme amounts unders and overs account for the most recently completed regulatory year (t–2), the current regulatory year (t–1) and the next regulatory year (t):

1. An opening balance for year t–2, year t–1 and year t;
2. An interest charge for one year on the opening balance for each regulatory year (t–2, t–1 and t). These adjustments are to be calculated using the respective nominal weighted average cost of capital (WACC) for each intervening year between regulatory year t–2 and year t.⁵² The WACC applied for each year will be that approved by the AER for the relevant year;
3. The amount of revenue recovered from jurisdictional scheme amounts charges in respect of that year, less the total annual revenue for the year in question;
4. An adjustment to the net amount in item 3 by six months of interest. These adjustments are to be calculated using the approved nominal WACC;
5. The total sum of items 1–4 to derive the closing balance for each year.

TasNetworks must provide details of calculations in the format set out in table 14.5. Amounts provided for the most recently completed regulatory year (t–2) must be audited. Amounts provided for the current regulatory year (t–1) will be regarded as an estimate. Amounts for the next regulatory year (t) will be regarded as a forecast.

In proposing variations to the amount and structure of jurisdictional scheme charges, TasNetworks is expected to achieve a closing balance as close to zero as practicable in its jurisdictional scheme amounts unders and overs account in each forecast year in its annual pricing proposal during the 2017–19 regulatory control period.

⁵⁰ Jurisdictional scheme amounts, are amounts a distributor is required under a jurisdictional scheme obligation as defined by the NER to: pay a person; pay into a fund established under an Act of a participating jurisdiction; credit against charges payable by a person; or reimburse a person, less any amounts recovered by the distributor from any person in respect of those amounts other than under the NER.

⁵¹ NER, cll. 6.12.1(20), 6.18.2(b)(6A), 6.18.7(A)(b) and (c).

⁵² The WACC for each year will be that approved by the AER for the respective year and as calculated as set out in Figure 14.1.

Table 14.5 Example calculation of jurisdictional scheme amounts unders and overs account (\$'000, nominal)

	Year t-2 (actual)	Year t-1 (estimate)	Year t (forecast)
(A) Revenue from jurisdictional schemes	19 777	23 121	26 965
(B) Less jurisdictional scheme payments for regulatory year =	20 272	20 959	28 641
+ Jurisdictional scheme 1 payments	14 159	13 954	13 961
+ Jurisdictional scheme 2 payments	6113	7005	14 680
(A minus B) Under/over recovery of revenue for regulatory year	-495	2162	-1676^a
<i>Jurisdictional scheme amount unders and overs account</i>			
Nominal WACC (per cent)	5.00%	5.50%	6.00%
Opening balance	-52	-562 ^b	1628
Interest on opening balance	-3	-31	98
Under/over recovery of revenue for regulatory year	-495	2162	-1676 ^a
Interest on under/over recovery for regulatory year	-12	59	-50
Closing balance	-562	1628	0^c

Notes: (a) Approved jurisdictional scheme amounts revenue under/over recovery for regulatory year t.
(b) Opening balance is the previous year's closing balance.
(c) TasNetworks is expected to achieve a closing balance as close to zero as practicable in its jurisdictional scheme amount unders and overs account in each forecast year in its annual pricing proposals in the 2017–19 regulatory control period.

D Assigning retail customers to tariff classes

We are required to decide on the principles governing assignment or reassignment of retail customers (customers) to or between tariff classes.⁵³ Our decision on the principles that TasNetworks is to adhere to in assigning and reassigning customers to tariff classes is outlined below.

D.1 AER's assessment approach

We must have regard to the principles set out in the NER when formulating provisions which TasNetworks must apply with assignment or reassignment of customers to tariff classes.⁵⁴ A distributor's decision to assign a customer to a particular tariff class or to reassign a customer from one tariff class to another should be subject to an effective system of assessment and review.⁵⁵

D.2 Reasons for the draft decision

TasNetworks did not propose an approach to assigning and reassigning retail customers to tariff classes.

We consider that an effective review system should clearly set out the process of escalation and the review system should be visible and transparent. We consider the following principles for assigning or reassigning customers to tariff classes provides for this visibility and transparency and will apply to TasNetworks for the 2017–19 regulatory control period. It includes a specific process for assigning or reassigning customers to alternative control services.

D.3 Procedures for assigning and reassigning retail customers to tariff classes

The procedure outlined in this section applies to direct control services.

Assignment of existing retail customers to tariff classes at the commencement of the 2017–19 regulatory control period

1. TasNetworks' customers will be taken to be "assigned" to the tariff class which TasNetworks was charging that customer immediately prior to 1 July 2017 if:
 - (a) they were a TasNetworks customer prior to 1 July 2017, and
 - (b) they continue to be a customer of TasNetworks as at 1 July 2017.

⁵³ NER, cl. 6.12.1(17).

⁵⁴ NER, cl. 6.18.4.

⁵⁵ NER, cl. 6.18.4(4).

Assignment of new retail customers to a tariff class during the 2017–19 regulatory control period

2. If, from 1 July 2017, TasNetworks becomes aware that a person will become a customer of TasNetworks, then TasNetworks will determine the tariff class to which the new customer will be assigned.
3. In determining the tariff class to which a customer or potential customer will be assigned, or reassigned, in accordance with paragraphs 2 or 5, TasNetworks will take into account one or more of the following factors:
 - (a) the nature and extent of the customer's usage
 - (b) the nature of the customer's connection to the network
 - (c) whether remotely–read interval metering or other similar metering technology has been installed at the customer's premises as a result of a regulatory obligation or requirement.
4. In addition to the requirements under paragraph 3, TasNetworks, when assigning or reassigning a customer to a tariff class, will ensure the following:
 - (a) that customers with similar connection and usage profiles are treated on an equal basis
 - (b) those customers who have micro–generation facilities are treated no less favourably than customers with similar load profiles but without such facilities.

Reassignment of existing retail customers to another existing or a new tariff class during the 2017–19 regulatory control period

5. TasNetworks may reassign an existing customer to another tariff class in the following situations:
 - (a) TasNetworks receives a request from the customer or customer's retailer to review the tariff to which the existing retail customer is assigned; or
 - (b) TasNetworks believes that:
 - i. an existing customer's load characteristics or connection characteristics (or both) have changed such that it is no longer appropriate for that customer to be assigned to the tariff class to which the customer is currently assigned, or
 - ii. a customer no longer has the same or materially similar load or connection characteristics as other customers on the customer's existing tariff, then TasNetworks may reassign that customer to another tariff class.

Notification of proposed assignments and reassignments and rights of objection for standard control services

6. TasNetworks must notify the customer's retailer in writing of the tariff class to which the customer has been assigned or reassigned, prior to the assignment or reassignment occurring.
7. A notice under paragraph 6 above must include advice informing the customer's retailer that they may request further information from TasNetworks and that the customer or customer's retailer may object to the proposed reassignment. This notice must specifically include:
 - (a) a written document describing TasNetworks' internal procedures for reviewing objections, if the customer's retailer provides express consent, a soft copy of such information may be provided via email
 - (b) that if the objection is not resolved to the satisfaction of the customer or customer's retailer under TasNetworks internal review system within a reasonable timeframe, then, to the extent resolution of such disputes are with the jurisdiction of the Energy and Water Ombudsman Victoria or like officer, the customer or customer's retailer is entitled to escalate the matter to such a body
 - (c) that if the objection is not resolved to the satisfaction of the customer or customer's retailer under TasNetworks internal review system and the body noted in paragraph 7(b) above, then the customer or customer's retailer is entitled to seek a decision of the AER via the dispute resolution process available under Part 10 of the NEL.
8. If, in response to a notice issued in accordance with paragraph 6 above, TasNetworks receives a request for further information from a customer or customer's retailer, then it must provide such information within a reasonable timeframe. If TasNetworks reasonably claims confidentiality over any of the information requested by the customer or customer's retailer, then it is not required to provide that information to the customer or customer's retailer. If the customer or customer's retailer disagrees with such confidentiality claims, he or she may have resort to the complaints and dispute resolution procedure, referred to in paragraph 7 above (as modified for a confidentiality dispute).
9. If, in response to a notice issued in accordance with paragraph 6 above, a customer or customer's retailer makes an objection to TasNetworks about the proposed assignment or reassignment, TasNetworks must reconsider the proposed assignment or reassignment. In doing so TasNetworks must take into consideration the factors in paragraphs 3 and 4 above, and notify the customer or customer's retailer in writing of its decision and the reasons for that decision.
10. If an objection to a tariff class assignment or reassignment is upheld by the relevant body noted in paragraph 7 above, then any adjustment which needs to be made to tariffs will be done by TasNetworks as part of the next network bill.
11. If a customer or customer's retailer objects to TasNetworks' tariff class assignment TasNetworks must provide the information set out in paragraph 7 above and adopt and comply with the arrangements set out in paragraphs 8, 9 and 10 above in respect of requests for further information by the customer or customer's retailer and resolution of the objection.

Notification of proposed assignments and reassignments and rights of objection for alternative control services

12. TasNetworks must make available information on tariff classes and dispute resolution procedures referred to in paragraph 7 above to retailers operating in TasNetworks' distribution area.
13. If TasNetworks receives a request for further information from a customer or customer's retailer in relation to a tariff class assignment or reassignment, then it must provide such information within a reasonable timeframe. If TasNetworks reasonably claims confidentiality over any of the information requested, then it is not required to provide that information. If the customer or customer's retailer disagrees with such confidentiality claims, he or she may have resort to the dispute resolution procedures referred to in paragraph 7 above, (as modified for a confidentiality dispute).
14. If a customer or customer's retailer makes an objection to TasNetworks about the proposed assignment or reassignment, TasNetworks must reconsider the proposed assignment or reassignment. In doing so TasNetworks must take into consideration the factors in paragraphs 3 and 4 above, and notify the customer or customer's retailer in writing of its decision and the reasons for that decision.
15. If an objection to a tariff class assignment or reassignment is upheld by the relevant body noted in paragraph 7 above, then any adjustment which needs to be made to tariffs will be done by TasNetworks as part of the next network bill.

System of assessment and review of the basis on which a retail customer is charged

16. Where the charging parameters for a particular tariff result in a basis charge that varies according to the customer's usage or load profile, TasNetworks will set out in its pricing proposal a method of how it will review and assess the basis on which a customer is charged.